

## **Sustainable Finance – Hungary**

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### **(I) Sustainable Ownership/ Shareholder Governance**

#### *(1) General aspects on the use of voting rights by investment companies*

The Hungarian Act LXVII of 2019 on the encouragement of long-term shareholder engagement (in the following ELTSE) merely repeats the text of EU Directive 2017/828.

The institutional investors and the asset managers shall elaborate an engagement policy, which is part of their investment strategy.<sup>1</sup> The engagement policy shall contain the mode of exercising of voting rights or other rights connected to shares.<sup>2</sup> The reasoning of Article 9 mentions that the Directive uses the phrase “the relevant stakeholders of the investee companies” twice in the related section. The term “interested parties” has no equivalent in Hungarian law, but it can be clearly established based on international and EU case law that there are four main categories of interested parties: investors, employees (employees and their representative bodies), creditors and suppliers. However, the concept of ‘stakeholder’ or ‘relevant stakeholder’ cannot be defined in a taxonomy, since in practice companies have a specific group of subjects which are economically linked to them and are therefore directly or even indirectly involved in the company's activities. Thus, for example, in the case of a company that may also be a polluter, such a stakeholder could be the local community of residents. The institutional investor should describe in the engagement policy of the company the persons whose interests are significantly affected by the activities of the company and how it will communicate with them.

The institutional investors and the asset managers shall annually and publicly disclose their engagement policy, among others also the general description of their voting behaviour and the explanation of the most significant votes.<sup>3</sup> They shall publicly disclose how they have cast votes in the general meetings of companies in which they hold/own shares, excluding such votes those subject matter or proportion of company ownership are insignificant.<sup>4</sup>

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<sup>1</sup> Section 9 (1) ELTSE

<sup>2</sup> Section 9 (2) c) ELTSE

<sup>3</sup> Section 10 (1) ELTSE

<sup>4</sup> Section 10 (1) ELTSE

If the asset manager fulfills the engagement policy in the name of the institutional investor, including of voting, then the institutional investor shall give the place of publicly disclosure related to voting information.<sup>5</sup>

If the institutional investor or the asset manager decides fully or partly not to go through the above mentioned provisions, then they are obliged to give obvious explanation with arguing in a reference publicly disclosed on their website<sup>6</sup> (comply-or-explain).

The Hungarian Civil Code<sup>7</sup> (hereafter HCC) regulates the voting rights and the voting in public company limited by shares. The shares shall grant voting rights in proportion to their nominal value; except for the cases specified in the HCC, provisions of the articles of association attaching extra rights to certain shares shall be null and void.<sup>8</sup> The shareholders shall not exercise their voting rights before they have provided their contributions in cash or in kind.<sup>9</sup> Members may exercise their rights by means of electronic communications instead of personal attendance at the meeting of the supreme body, if the instrument of incorporation specifies the electronic communications equipment allowed to be used, as well as the condition and the mode of their use, in a manner that ensures the identification of members and their mutual and unrestricted communication.<sup>10</sup> If the articles of association of a public company limited by shares allow for exercising voting rights by mail before the general meeting, the exercise of that right may only be made subject to the establishment of the identity of shareholders.<sup>11</sup> When adopting a resolution, no vote shall be cast by those:

- a) who, by the resolution, would be exempted from an obligation or responsibility or would gain certain other kind of advantage to the detriment of the legal person;
- b) with whom, according to the resolution, a contract would have to be concluded;
- c) against whom, according to the resolution, legal action would have to be brought;
- d) whose relative, being neither a member nor a founder of the legal person, has a vested interest in the resolution;
- e) who have a relationship based on majority control with an organisation having a vested interest in the resolution;
- f) who are personally interested in the resolution.<sup>12</sup>

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<sup>5</sup> Section 10 (3) ELTSE

<sup>6</sup> Section 11 ELTSE

<sup>7</sup> Act V of 2013

<sup>8</sup> Section 3:260 (1) HCC

<sup>9</sup> Section 3:260 (2) HCC

<sup>10</sup> Section 3:111 (2) HCC

<sup>11</sup> Section 3:273 (4) HCC

<sup>12</sup> Section 3:19 (2) HCC

The holders of voting preference shares may exercise multiple voting rights to the extent specified by the articles of association.<sup>13</sup> The volume of voting rights attached to a single share of a public company limited by shares shall not exceed ten times the voting rights corresponding to the nominal value of the share; any provision of the articles of association to the contrary shall be null and void.<sup>14</sup> In the case of voting preference shares with a veto right, general meetings shall adopt resolutions by a simple majority vote of holders of such shares attending and being in favour of the resolution at hand or, if there is only one voting preference share, resolutions shall only be adopted if supported by the holder of this share.<sup>15</sup>

*(2) Factual/economic obstacles to a meaningful „engagement policy” as defined in Art. 3g EU Directive 2017/828 by mutual fund*

One can mention different obstacles laid out in ELTSE: these are rules in connection with shareholder proxy advisor’s transparency and legal status<sup>16</sup> and the approval of related party transactions<sup>17</sup> (as same in the EU Directive 2017/828). The proxy advisors shall mark (not disclose!) the code of conduct applied by them and report on its application.<sup>18</sup> If the proxy advisors do not apply a code of conduct, they shall clear and reasoned explain it.<sup>19</sup> If the proxy advisors depart of any recommendation of the code of conduct, they shall declare from which parts they depart, furthermore shall explain the depart, indicating the adopted measures.<sup>20</sup> This information shall be disclosed free of charges on the websites of proxy advisors, and shall be updated per year.<sup>21</sup> In order to adequately inform their clients about the accuracy and reliability of their activities, the proxy advisors shall publicly disclose on an annual basis at least all of the following information in relation to the preparation of their research, advice and voting recommendations:

- the essential features of the methodologies and models they apply;
- the main information sources they use;

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<sup>13</sup> Section 3:232 (1) HCC

<sup>14</sup> Section 3:232 (1) HCC

<sup>15</sup> Section 3:232 (2) HCC

<sup>16</sup> Section 14-15 ELTSE

<sup>17</sup> Sections 14-15, 23-27 ELTSE

<sup>18</sup> Section 14 (1) ELTSE

<sup>19</sup> Section 14 (2) ELTSE

<sup>20</sup> Section 14 (1) ELTSE

<sup>21</sup> Section 14 (3) ELTSE

- the procedures put in place to ensure quality of the research, advice and voting recommendations and qualifications of the staff involved;

- whether and, if so, how they take national market, legal, regulatory and company-specific conditions into account;

- the essential features of the voting policies they apply for each market;

- whether they have dialogues with the companies which are the object of their research, advice or voting recommendations and with the stakeholders of the company, and, if so, the extent and nature thereof;

- the policy regarding the prevention and management of potential conflicts of interests.<sup>22</sup>

The proxy advisors shall be made these information publicly available on their websites and free of charge for at least three years from the date of publication.<sup>23</sup> The information does not need to be disclosed separately where it is available as part of the disclosure of their code of conduct.<sup>24</sup> The proxy advisors shall identify and disclose without delay to their clients any actual or potential conflicts of interests or business relationships that may influence the preparation of their research, advice or voting recommendations and the actions they have undertaken to eliminate, mitigate or manage the actual or potential conflicts of interests.<sup>25</sup> These provisions shall also applied to proxy advisors that have neither their registered office nor their head office in the European Union which carry out their activities through an establishment located in the European Union.<sup>26</sup>

The public company limited by shares shall disclose the information on material transactions with related party on its website, at latest the executing of transaction, with the following content:

- the information on nature of relationship with related party;

- the name of related party;

- the date and the value of transaction;

- the required information to the evaluation of transaction, whether it was or not fair and reasonable from the aspect of company and related party (including the minority shareholders).<sup>27</sup> The material transaction is those value exceeds 1 % of revised/corrected revenue of the previous business year on the base of International Financial Reporting

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<sup>22</sup> Section 15 (1) ELTSE

<sup>23</sup> Section 15 (2) ELTSE

<sup>24</sup> Section 15 (2) ELTSE

<sup>25</sup> Section 15 (3) ELTSE

<sup>26</sup> Section 15 (4) ELTSE

<sup>27</sup> Section 23 (1) ELTSE

Standard 15 Revenue from contracts with customers.<sup>28</sup> These provisions shall not be applied:

- transaction entered in the ordinary course of business and among normal market conditions;
- transactions entered into between the company and its subsidiaries provided that they are wholly owned or that no other related party of the company has an interest in the subsidiary enterprise or the law provides for adequate protection of interests of the company, of the subsidiary and of their shareholders who are not a related party, including minority shareholders in such transactions;
- clearly defined types of transactions for which national law requires approval by the general meeting, provided that fair treatment of all shareholders and the interests of the company and of the shareholders who are not a related party, including minority shareholders, are specifically addressed and adequately protected in such provisions of law;
- transactions regarding remuneration of directors, or certain elements of remuneration of directors, awarded or due in accordance with remuneration policy;
- transactions entered into by credit institutions on the basis of measures, aiming at safeguarding their stability, adopted by the competent authority in charge of the prudential supervision within the meaning of European Union law;
- transactions offered to all shareholders on the same terms where equal treatment of all shareholders and protection of the interests of the company is ensured.<sup>29</sup>

The material transactions with related parties shall be approved by the management body of company (board of directors). The articles of association may provide that the material transactions with related parties shall be approved by general meeting or by supervisory board (if it exists at the company).<sup>30</sup> Such person, who is directly concerned in the transaction with related party (including if the concerned person is the related party), may not participate in the decision-making.<sup>31</sup> The management or the supervisory board of company shall elaborate such an internal process which is suited for prohibiting the related parties to get advantage from their positions, and for ensuring the protection of interests of company and of shareholders who are not related parties, including the minority shareholders.<sup>32</sup>

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<sup>28</sup> Section 23 (3) ELTSE

<sup>29</sup> Section 24 ELTSE

<sup>30</sup> Section 25 (1) ELTSE

<sup>31</sup> Section 25 (3) ELTSE

<sup>32</sup> Section 25 (2) ELTSE

The Hungarian Capital Market Act (in the following CMA) regulates the acquisition of control via mandatory public bid (offer to purchase).<sup>33</sup>

*(3) Restriction of investment strategy to portfolio companies in free float?*

For these questions, we can find rules in the Act CXXXVIII of 2007 on investment enterprises and commodity exchange service providers, and on rules of their activities (in the following IECESP) and in the Act CCXXXVII of 2013 on credit institutions and financial enterprises (in the following CIFE).

The investment enterprise may not acquire the following during its portfolio management as a tax on portfolio managed for its party/client:

- financial instrument issued by itself,
- financial instrument issued by related enterprise (not including securities entered in the regulated market and securities which are the subject of trading in the multilateral trading system),
- acquisition of control via mandatory public bid (offer to purchase) under CMA.<sup>34</sup>

The investment enterprise may not enter into transaction of securities entered in the regulated market and of securities that are the subject of trading in the multilateral trading system with person/organization wherein it has qualified majority/influence or these have in it during its portfolio management as a tax on portfolio managed for its party/client.<sup>35</sup> The IECESP regulates the intra-group financial support:<sup>36</sup> it can be credit, guaranty and transfer of instruments using as safeguards; the CIFE also contains same rules.<sup>37</sup>

At the dependent agency may not be qualified as agency fee the allowance/charge in cash from the financial service, the additional financial service, the investment service and the additional investment service performed by parent company for subsidiary or by subsidiary for parent company.<sup>38</sup>

The CIFE regulates the corporate governance and risk management under the 575/2013 EU regulation,<sup>39</sup> it does not contain any ESG-compliant investment strategy.

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<sup>33</sup> Sections 68-78 CMA

<sup>34</sup> Section 72 (1) IECESP

<sup>35</sup> Section 72 (2) IECESP

<sup>36</sup> Section 110/M IECESP

<sup>37</sup> Section 257/A-257/E CIFE related to financial support by parent company for subsidiary, by subsidiary for parent company and between subsidiaries.

<sup>38</sup> Section 71 (3a) CIFE

<sup>39</sup> Sections 107-115 CIFE

Both IECESP and CIFE regulate the group financial support agreement.<sup>40</sup>

*(4) On conflicts of interest as a result of collaborations in activist voting*

The holders of shares belonging to the same series shall not be discriminated against in connection with the exercise of their shareholder rights.<sup>41</sup> The shareholders shall be entitled to attend, request information and make observations and proposals at the general meeting and, if in possession of shares with a voting right, cast their votes.<sup>42</sup> Shareholders shall not exercise their voting rights before they have provided their contributions in cash or in kind.<sup>43</sup>

The shareholders may exercise shareholder rights through representatives; executive officers, supervisory board members and the auditor may not represent shareholders.<sup>44</sup> In the case of a shareholder represented by more than one representative, if the votes or statements of the representatives differ, those votes and statements shall be null and void.<sup>45</sup>

A shareholder may appoint an agent to exercise his shareholder rights, who, after being registered in the shareholder register, shall act in his own name and for the benefit of the shareholder.<sup>46</sup>

For contracts on the transfer of assets between the company and its shareholders to be concluded within two years from the registration of a public company limited by shares, the resolution of the general meeting on its prior consent to the transfer shall be required if the value of the consideration to be paid by the company reached one-tenth of its share capital. In such procedures, the rules on the contributions in kind shall apply accordingly, with the proviso that the report of the auditor or expert shall be published.<sup>47</sup> The prior consent of the general meeting shall also be needed if the contract is concluded between the company and a shareholder or his close relative, or any entity over which the shareholder has majority control.<sup>48</sup> No prior consent by the general meeting shall be required for contracts related to the activities of the company of ordinary scale, for the acquisition of ownership by a decision of an authority or by official auction, or for stock exchange transactions.<sup>49</sup> For the purposes of this section, the term

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<sup>40</sup> Sections 110/M-110/Q IECESP; Sections 257/A-257/E CIFE

<sup>41</sup> Section 3:253 HCC: equality of shareholders

<sup>42</sup> Section 3:257 HCC: right to attend the general meeting

<sup>43</sup> Section 3:260 (2) HCC

<sup>44</sup> Section 3:255 (1) HCC: shareholder representation

<sup>45</sup> Section 3:255 (2) HCC

<sup>46</sup> Section 3:256 HCC: shareholder's agent

<sup>47</sup> Section 3:264 (1) HCC: conditions for the acquisition of assets

<sup>48</sup> Section 3:264 (2) HCC

<sup>49</sup> Section 3:264 (3) HCC

shareholder shall mean persons holding shares in a company at the date when a resolution on the transformation of the company into a public company limited by shares is adopted, and any shareholder who holds at least ten per cent of the voting rights after the subsequent registration of the public company limited by shares.<sup>50</sup>

Besides the private law, we can find several rules in public law. The securities depository, the depository or the CSD may, on the basis of a written contract with the shareholder as the proxy advisor (referred to as proxy advisor), exercise the shareholder's rights in his own name in favour of the shareholder in relation to the public company limited by shares.<sup>51</sup> The proxy advisor may exercise all the shareholder rights that the shareholder is entitled to exercise. A proxy advisor may exercise shareholder rights only based on shares registered in a securities account held by him or deposited with him.<sup>52</sup> A proxy advisor may exercise shareholder rights in relation to the company after being entered in the share register as a proxy holder. The entry must specify the number of shares, by class of shares, on which the rights are based. If the acquisition of ownership in a public company limited by shares is subject to authorisation by a public authority, a proxy advisor may be entered in the share register only together with the shareholder or, in the case of secondary securities issued on shares of a public company limited by shares having its registered office in the territory of the country, with the holder (ultimate beneficiary) of such securities.<sup>53</sup> The proxy advisor must indicate or declare that s/he is not acting as owner but as shareholder proxy.<sup>54</sup> In matters not regulated by this Act, the provisions of HCC relating to contracts of agency shall apply to the contract between the shareholder and the proxy advisor and to the exercise of shareholder rights by the proxy advisor.<sup>55</sup>

*(5) On the need for cooperation with lending banks*

Investment enterprises, investment fund managers, collective investment undertakings, central securities depositories, financial institutions, voluntary mutual funds, occupational pension funds, private pension funds and insurance companies shall notify the supervisory authority

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<sup>50</sup> Section 3:264 (4) HCC

<sup>51</sup> Section 151 (1) CMA

<sup>52</sup> Section 151 (2) CMA

<sup>53</sup> Section 152 CMA

<sup>54</sup> Section 153 (1) CMA

<sup>55</sup> Section 155 (4) CMA. See also: Ádám Auer: Részvényes képviselője. In: Dúl János – Lehoczki Zóra Zsófia – Papp Tekla – Veress Emőd (ed.): Társasági jogi lexikon. Dialóg Campus, Budapest, 2019. 212.



(Hungarian National Bank) prior to the commencement of their activities if they intend to engage in securities lending. The notification must be accompanied by a certificate from the Central Credit Information System (CCIS; “Központi Hitelinformációs Rendszer” abbreviated as “KHR”) confirming the existence of membership if the securities lending is not carried out for reference data providers.<sup>56</sup>

The securities lending requires the conclusion of a securities lending framework agreement or securities lending agreement with the holder of the securities. The securities lending framework agreement or securities borrowing agreement may not form part of any other contract between the holder of the securities and the other party to the securities lending agreement.<sup>57</sup>

The securities lending or borrowing agreement must contain:

- the name, ISIN code and series of the securities that may be lent or are being lent;
- the amount of the security to be lent or lent out;
- in the case of a framework contract, the period during which the security may be lent;
- the duration of the securities loan;
- the lending fee;
- a statement that the lender may not exercise the rights embodied in and relating to the security during the term of the loan; and
- in the case of shares, the agreement of the parties as to the exercise of voting rights.<sup>58</sup>

In the event of the liquidation of an investment fund manager, financial assets deposited or funds held by the client with the fund manager, financial assets owned by or belonging to the client and funds and services provided to the client in an account for the account of the client shall not form part of the assets of the liquidation.<sup>59</sup> In the event of the liquidation of the investment fund manager, the debt arising from the subordinated loan capital and additional subordinated loan capital shall be paid by the Bankruptcy Act (Act XLIX of 1991) 57(1)(g) [default interest and default interest surcharges, as well as surcharges and penalties, irrespective of the time when and the legal title on which they were incurred,] shall be satisfied after satisfaction of the debt.<sup>60</sup>

The investment enterprise, the investment fund manager, the collective investment enterprise, the central securities depository, the financial institution, the voluntary mutual insurance fund,

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<sup>56</sup> Section 168 (1) CMA

<sup>57</sup> Section 170 (1) CMA

<sup>58</sup> Section 170 (2) CMA

<sup>59</sup> Section 48 (1) of Act XVI of 2014 on forms of collective investment and their managers and amending certain financial laws (in the following: FCITM)

<sup>60</sup> Section 48 (5) FCITM

the occupational pension fund, the private pension fund and the insurer shall notify the supervisory authority (HNB) before commencing their activities if they wish to practice securities-borrowing.<sup>61</sup> Lending of securities requires the conclusion of a framework loan agreement or a securities loan agreement with the owner of the security; a securities lending framework agreement or a securities loan agreement may not be part of another agreement entered into between the owner of the security and the other party borrowing the security.<sup>62</sup>

*(6) On the inclusion of fund companies domiciled outside the EU*

In order to grant an authorization of investment services or of ancillary services, the supervisory authority (HNB) shall first seek the opinion of the relevant competent supervisory authority of another EEA State if the applicant investment enterprise:

- an investment enterprise, credit institution or insurance subsidiary established in another EEA State;
- a subsidiary of the parent enterprise of an investment enterprise, credit institution or insurance enterprise established in another EEA State;
- its controlling owner has a controlling influence in an investment enterprise, credit institution or insurance enterprise established in another EEA State.<sup>63</sup>

The supervisory authority (HNB) shall authorize the branch of an investment enterprise established in a third country to provide investment services and provide ancillary services upon the request of the enterprise established in a third country, if

- presents his authorization from the competent supervisory authority of the place where it is established;
- the Authority has entered into an agreement with the competent supervisory authority of the third country where the investment enterprise is established that fully complies with the rules set out in Article 26 of the Organization for Economic Co-operation and Development (OECD) Model Taxation and Income Tax the effective exchange of information, including, where appropriate, in relation to multilateral tax agreements;
- the Authority has entered into a cooperation agreement with the competent supervisory authority of an investment enterprise established in a third country;

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<sup>61</sup> Section 168 (1) CMA

<sup>62</sup> Section 170 (1) CMA

<sup>63</sup> Section 29 IECESP

- the third country in which the investment enterprise has its registered office is not included in the list of countries and territories not cooperating with the Financial Action Task Force (FATF);
- complies with the rules on initial capital;
- senior officials comply with the conditions of employment;
- certifies that it is a member of a recognized investor-compensation scheme.<sup>64</sup>

The supervisory authority (HNB) shall reject an application for a license to perform investment services in the case of a branch of a foreign investment enterprise even if

- there is no valid and effective international cooperation agreement between the authority and the supervisory authority of the place where the applicant is established, based on the mutual recognition of the supervisory authorities and including the supervision of branches;
- the state of the applicant's domicile does not have legal provisions against money laundering and terrorist financing that meet the requirements of Hungarian law;
- the applicant does not have a data processing policy that meets the requirements of the legislation and directly applicable legal acts of the European Union;
- the applicant does not declare that it is fully liable for the obligations arising under the trade name of the branch;
- the applicant fails to submit the authorization or statement of consent of the supervisory authority of the place of establishment to establish a branch;
- the law of the State in which the applicant is established does not ensure prudent, safe operation;
- the applicant does not have its head office in the country in which it is established.<sup>65</sup>

A branch of an investment enterprise established in a third country shall report annually to the supervisory authority (HNB).<sup>66</sup>

The supervisory authority (HNB) shall reject an application by a UCITS (collective investment enterprise for transferable securities as a fund manager) manager for authorization to carry on investment fund management activities if the applicant has a close relationship with a person or organization that is domiciled or established in a third country whose legislation or the

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<sup>64</sup> Section 29/A (1) IECESP

<sup>65</sup> Section 30 (2) IECESP

<sup>66</sup> Section 31/A IECESP

enforcement of that legislation impedes the effective and efficient supervision of the investment fund manager.<sup>67</sup>

The provisions of nominee in CMA shall apply to the domestic activities of a foreign shareholder proxy, with the exception that his liability towards his foreign clients shall be governed by the foreign rules applicable to him.<sup>68</sup>

*(7) On the inclusion of debt investors in the activist program*

Institutional investors and asset managers shall develop an engagement policy that describes how to incorporate shareholder participation into their investment strategy; the engagement policy shall include – among others - how they engage in a dialogue with the companies involved in the investment.<sup>69</sup> The proxy adviser shall disclose at least the following information on an annual basis in relation to the preparation of its research, advice and voting recommendations in order to provide adequate information to clients on the accuracy and reliability of its activities – among others - whether and to what extent it engages in a dialogue with the companies and stakeholders that are the subject of its research, advice or voting recommendations.<sup>70</sup>

„The Hungarian National Bank (HNB) is convinced that it is essential for the operation of the listed and long-term successful companies – beside the responsible corporate governance by management - the active shareholder involvement/engagement in monitoring and controlling the operation of the company. The shareholder - if many times even in a small part, but - the owner of the listed company. Today, beside the proactive supervisory action, it has therefore become necessary to strengthen corporate ownership control. Therefore, the HNB encourages shareholders to continue to the best of their ability monitor issuers' disclosures, exercise their ownership rights, participate in at general meetings, ask questions, find out and exercise their voting rights!”<sup>71</sup>

„The first issue of corporate green bonds took place in the summer of 2020 within the framework of the HNB's Growth Bond Program. With this issue with a nominal value of HUF

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<sup>67</sup> Section 10 (1) d) FCITM

<sup>68</sup> Section 155 (3) CMA

<sup>69</sup> Section 9 (1), (2) b) ELTSE

<sup>70</sup> Section 15 (1) f) ELTSE

<sup>71</sup> Barnóczki Péter (Director of Capital Market and Consumer Protection Enforcement of HNB): Fenntartható(bb)an működő tőzsdei cégeket! (Sustainable listed companies!), 3.; <https://www.mnb.hu/letoltes/19-07-23-barnoczki-peter-srd-hosszu.pdf>; 27. 01. 2022.

30 billion, the development of the corporate green bond market in Hungary started, which has since been followed by 3 other companies. Each of the bonds is part of a corporate Green Bond Framework that external auditors complying with international standards (Green Bond Principles) have been certified. Within the total HUF 1,400 billion GNP corporate bond portfolio, the nominal value of corporate green bonds its proportion now exceeds 10 percent. The issuance of green corporate bonds in Hungary has so far been a real estate developer sector, which is a key area for reducing CO<sub>2</sub> emissions and mitigating climate risks. Another element of the central bank's green initiatives is the green capital requirement introduced by the HNB at the end of 2020, thanks to which investors buying green corporate bonds receive a discount on the given from the capital requirement for the asset. The program may allow for lower cost funding, which companies that issue green securities can also raise funds on more favorable terms. Compliance with environmental objectives is ensured by the HNB with an easy-to-operate, transparent, but sufficiently strict set of conditions that are in line with international best practice: accordingly, green bonds should comply with the Green Bond Principle required by ICMA and with a favorable green rating from an external independent partner they must have a specific green rating. The HNB also examines the commitment of bond issuers to sustainable development, thereby reducing the so-called. "Green washing" risk - in the near future, for example, this will be the so-called SBTi (Science Based Target) or similarly explicit emission reduction targets. Where the bonds they do not meet the expectations from a green point of view in the future, for example, the environmental impact of the projects is below the company level, or there is a lack of compliance with the green objectives in the issuer's general activities ("Green default"), the HNB may decide to sell the bonds.<sup>72</sup> In addition, the move by banks to green clientele will also be encouraged by the Hungarian National Banks's green investment capital relief in Hungary. The Taxonomy Regulation is also an important part of domestic financial market incentives, such as the Green Recommendation issued by the HNB<sup>73</sup> or the Budapest Stock Exchange ESG Reporting Guideline.<sup>74</sup>

The HNB has played a significant role in launching and ramping up green bonds in Hungary through the Growth Bond Programme (GBP) launched in 2019, with the first issuance taking

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<sup>72</sup> Fenntarthatóság és jegybanki politika – zöld szempontok az MNB monetáris politikai eszköztárában (Sustainability and central banking policy – green aspects of the HNB's monetary policy instrument), 22-23.; <https://www.mnb.hu/letoltes/zold-eszkoztar-strategia-publikacio-2021-hun-0706-2.pdf>; 27. 01. 2022.

<sup>73</sup> 5/2021. (IV. 15.) HNB Recommendation on climate and environmental risks and the integration of environmental sustainability considerations into the activities of credit institutions. Another useful webpage: <https://www.mnb.hu/letoltes/zold-jogtar-0104-1.pdf>; 27. 01. 2022.

<sup>74</sup> <https://blog.kpmg.hu/2021/06/az-eu-taxonomiarendelet-hattere-es-varhato-jelentesi-kotelezettsegei/>; 27. 01. 2022.

place in the summer of 2020. However, it is a cause for concern that all of these were in the GBP until the end of September 2021. Green bonds account for 20% of the central bank's corporate bond portfolio, with a value of HUF 189 billion. Issuing companies have been able to raise a total of HUF 330 billion. However, the HNB will close the GBP as part of its tightening cycle, raising the question of whether there will be any more corporate green bond issuance. The other question is what will happen to the bonds already issued, or more precisely to the part of them that the central bank did not buy. For the time being, there is in practice no secondary market, as the investors are largely banks, which do not buy and sell the paper.<sup>75</sup>

*(8) On the relationship between „dialogue conducting/engagement” and equal information treatment of shareholders*

Members shall cooperate with each other and with the bodies of the business organisation, and they shall not engage in activities that jeopardise the achievement of the objectives of the company.<sup>76</sup> The shareholders belonging to the same series shall not be discriminated against in connection with the exercise of their shareholder rights.<sup>77</sup> At the shareholders' written request submitted at least eight days before the date set for the general meeting, the board of directors shall, at least three days before the date of the general meeting, provide all shareholders with information that may be necessary for the discussions of the items on the agenda of the general meeting.<sup>78</sup> At least fifteen days before the general meeting, the board of directors shall inform the shareholders of the key data in the account, as well as the report of the board of directors and the supervisory board.<sup>79</sup> Provisions of the articles of association restricting or excluding the right of shareholders to information shall be null and void.<sup>80</sup> If shareholders holding jointly at least one per cent of the votes in a public company limited by shares propose certain additions to or draft resolutions regarding certain items on or to be put on the agenda according to the rules on the details of an agenda item, the item proposed shall be deemed to have been put on the agenda if the proposal is communicated to the board of directors within eight days from the date of the publication of the notice convening the general meeting, and the board of directors shall, after receiving the proposal, publish a notice on the supplemented agenda or the draft

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<sup>75</sup> Gábor Kovács: Zöldségmérleg. hvg, 27. 01. 2022. 50-51.

<sup>76</sup> Section 3:88 (3) HCC

<sup>77</sup> Section 3:253 HCC: equality of shareholders

<sup>78</sup> Section 3:258 (1) HCC

<sup>79</sup> Section 3:258 (2) HCC

<sup>80</sup> Section 3:258 (3) HCC

resolutions presented by the shareholders (the item published in such notice shall be deemed to have been put on the agenda).<sup>81</sup> Provisions of the articles of association which make putting additional items on the agenda conditional upon a larger proportion of voting rights, or which provide for a shorter time limit for exercising such rights compared with that set out in the HCC shall be null and void.<sup>82</sup>

It is prohibited to define a takeover bid in a manner that violates the requirement of equal treatment of shareholders with respect to the statement of acceptance.<sup>83</sup> Violation of the requirement of equal treatment between shareholders in the exercise of the right to accept a takeover bid is prohibited.<sup>84</sup>

The guide/code shall not infringe the principle of equal treatment of individual members of the investment protection fund or jeopardize the safe management of the investment protection fund.<sup>85</sup>

The guide/code of the stock exchange must comply with the requirement of equal treatment for each stock exchange trader or issuer.<sup>86</sup>

The investor's rights under the unit of investment fund, a description of how the AIFM ensures fair treatment of investors and, if an investor receives or acquires preferential treatment, a description of the preferential treatment, the identification of the types of investors receiving preferential treatment and the specific where applicable, a description of their legal and economic relationship with the AIF or the AIFM (and other information on the subject).<sup>87</sup>

Hungary has mandated the Bank of China to arrange a yuan-denominated green sovereign Panda bond issue that is expected to be completed next week, the chief executive of Hungary's government debt management agency AKK said. "This will be the first green sovereign bond issue approved by Chinese authorities. We normally came out with bond issues of 1-2 billion yuan in China in previous years, this issue will likely be closer to 1 billion yuan (\$157.40 million) but we will see," Zoltan Kurali said in an interview with Reuters. Kurali said the aim of the transaction was to ensure Hungary's continuous market presence in China. In September 2021, Hungary sold \$2.25 billion worth of 10-year bonds and \$2 billion worth of 30-year bonds, and also issued 1 billion euros in seven-year eurobonds as the central European country

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<sup>81</sup> Section 3:259 (2) HCC

<sup>82</sup> Section 3:259 (3) HCC

<sup>83</sup> Section 69 (3) CMA

<sup>84</sup> Section 74 (4) CMA

<sup>85</sup> Section 225 (2) CMA

<sup>86</sup> Section 317 (9) CMA

<sup>87</sup> 3. appendix II. 10. FCITM

overhauled its 2021 financing plan. Yields on forint-denominated government bonds have jumped over the past weeks amid global uncertainty over the economic impact from the new wave of the coronavirus pandemic, and with HNB delivering a series of interest rate hikes to curb spiking inflation. Hungary sold 5-year benchmark bonds at an average yield of 4.28% at a Dec. 2 auction and 10-year bonds at 4.60%. On 4th December, the yield on these two papers was at 4.09% and 4.36% according to the AKK's fixing. "By now we see that an equilibrium level in yields has been reached, where we see inflows," Kurali said. "Based on data and auction results of the past one-and-a-half to two weeks we can see that, yes, there is still volatility but there are inflows into forint-denominated bonds." When asked about HNB's plan to phase out its bond purchase programme soon, Kurali said he did not expect that to have a significant impact on the local bond market. The bank has been winding down its bond purchases over the past several weeks. HNB was the first European Union central bank to start raising interest rates in June to combat inflation.<sup>88</sup>

## **(II) Sustainable Funding / Portfolio Governance**

### *(1) Generalities on the reorganization of funding management under ESG aspects*

The company establishes a remuneration policy for directors; the remuneration policy should contribute to the company's business strategy, long-term interests and sustainability and explain how it does so.<sup>89</sup>

The supervision (HNB) obliges the investment enterprise to consider realistic requirements and resources, both in terms of time horizon and the maintenance of own funds and liquid resources, if its liquidation or cessation of operations is necessary, taking into account the viability and sustainability of its business model and strategy. throughout the exit process.<sup>90</sup>

„SFDR serves several purposes: sustainability risks by financial market participants and financial advisers integration into their processes; taking into account adverse effects on

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<sup>88</sup> <https://www.reuters.com/markets/europe/hungary-issue-green-sovereign-bond-china-next-week-debt-agency-head-2021-12-08/>; 27. 01. 2022.

<sup>89</sup> Section 16 (19-(2) ELTSE

<sup>90</sup> Section 101 (9) IECESP



sustainability in these processes; - and increasing transparency regarding the sustainability characteristics of financial products. The HNB attaches great importance to SFDR, which prioritises sustainability and consumer protection; also with regard to Monitoring Strategy, and specifically for the Green Programme. Prudent application of SFDR for financial risks related to sustainability raising the awareness of organizations and customers, thereby managing risks; the expanding funding for sustainability and, in this context, financial institutions through the expansion of the information to be collected by the HNB - the activities of the HNB as a supervisory authority. The HNB's intention is to make the green, sustainable, investment and savings and expand the range of credit products and information on product offerings for investors be more informative, understandable and reliable, for which SFDR is an extremely important structural means a step. Specifically in connection with Article 3, the HNB draws attention to the following:

- integrating sustainability risks into investment decision-making processes, and the inclusion of sustainability risks in investment and insurance boards is not a new requirement, the SFDR only sets out the related transparency new obligations;
- for UCITS fund managers, AIFM and investment enterprises delegated Union legislation related to Article 3 is in the process of being issued, but they will also not contain detailed content elements with the requirements of Article 3 in connection with. However, the HNB recommends that the minimum sustainability risks be the policy referred to in Article 3 shall cover: the physical risks of climate change and the transition risk associated with climate change. In the opinion of the HNB, in the case of public investment funds, it is associated with the entry into force of the SFDR whether an amendment to the management rules is subject to authorization depends on whether the fund manager intends to amend the fund's investment policy or its risk profile in the context of the application of the Regulation.”<sup>91</sup>

*(2) On the conflicting relationship between ESG-compliant and prudential portfolio strategies*

With regard to credit institutions and investment enterprises, the provisions of the ELTSE on remuneration reporting shall apply if the Hungarian National Bank, acting in its area of responsibility for the supervision of the financial intermediation system, complies with the

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<sup>91</sup> Executive circular of HNB 17 March 2021 2., 5., 7.; <https://www.mnb.hu/letoltes/129526-3-2021-sfdr-vezetoi-korlevel.pdf>; 21. 02. 2022.

prudential requirements for credit institutions and investment enterprises pursuant to Article 450 (1) (j) of Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013.<sup>92</sup>

In order to facilitate efficient and effective risk management, the president of the HNB regulates the prudential requirements for non-performing exposures and restructured receivables in order to facilitate efficient and effective risk management.<sup>93</sup> The investment enterprise is required to manage the borrowed and own funds entrusted to it in such a way as to maintain its immediate solvency (liquidity) and current solvency at all times.<sup>94</sup>

An investment enterprise applying the group capital test in accordance with Article 8 of Regulation (EU) 2019/2033 shall apply the provisions on internal governance, transparency, risk management and remuneration on an individual basis. An investment enterprise applying prudential consolidation in accordance with Article 7 of Regulation (EU) 2019/2033 shall apply the provisions on internal governance, transparency, risk management and remuneration on an individual and consolidated basis. By way of derogation from paragraph 2, the provisions on internal governance, transparency, risk management and remuneration shall not apply to third-country subsidiaries subject to consolidated supervision if the parent undertaking of the Hungarian investment enterprise can demonstrate to the authority (HNB) that: the application of the provisions on internal governance, transparency, risk management and remuneration would be illegal under the law of the third country in which the subsidiary is established.<sup>95</sup>

The investment enterprise shall have in place a comprehensive, efficient and sound corporate governance system commensurate with the nature, scale and complexity of the risks inherent in the investment services, ancillary services and business model used and the internal control function

- (1) its organizational structure is clearly set out in its internal rules;
- (2) separates and clearly defines responsibilities and tasks;
- (3) control, prevent and eliminate conflicts of interest within the organization;
- (4) have effective procedures in place to identify, measure, manage, monitor and report on emerging risks;
- (5) apply internal control mechanisms, administrative and accounting procedures in accordance with the law;

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<sup>92</sup> Section 22 (2) ELTSE

<sup>93</sup> Section 18 (3) IECESP

<sup>94</sup> Section 105 (1) IECESP

<sup>95</sup> Section 3/C IECESP

- (6) the investment enterprise has a gender-neutral remuneration policy and practice that promotes its application, in accordance with effective and efficient risk management;
- (7) contribute to the smooth and efficient operation of the organization, the maintenance of trust in the institution and the protection of the economic interests and social objectives of the owners and customers in relation to the institution.<sup>96</sup>

„The HNB issued its Green Recommendation in April 2021. The measures proposed in it will increase the resilience of the banking sector to the crisis and also ensure that banks take sustainability considerations into account. Domestic banks are not yet prepared to deal with sustainability risks, but the HNB's green recommendation will help them prepare for the new international and domestic regulatory changes expected in the green area, said Vice-President Csaba Kandrács at the HNB's online conference. The managers of the banks must have sufficient knowledge and responsibility in the field of green risks, and in addition to the transformation of corporate governance, the banks must have a separate organizational function subordinated to the management body. They should assess the risks through, among other things, sensitivity and scenario analysis and stress testing. In the first step of the document, it is expected from the credit institution to develop a self-evaluation survey and an action plan to be submitted to the central bank by September 2021.”<sup>97</sup>

„Budapest Stock Exchange recommends that the issuer prepare and publish a timetable by 31 December 2021 containing at least the following information: the timing of compliance with the BSE recommendations, the year-on-year target ESG category between 2022 and 2025, improvements needed to reach the "advanced level". Issuers are encouraged to publish in 2023 a stand-alone ESG report for 2022 that meets at least the “entry level”. It is also recommended that issuers improve their ESG category during the above period. The first category is the “entry level” for which issuers report a stand-alone, non-standardized ESG published, which can be either a CSR (corporate responsibility report), a sustainability report or an ESG report. Since the report is not prepared in accordance with an international standard, it is not a requirement to be certified. In line with the principle of continuous improvement, "entry level" issuers are expected to reach the “middle tier” within 2 years. Switching between categories occurs when an issuer meets at least one of the requirements of the next level. In the case of an “entry level”, this is either the setting of objectives or the production of a standardized report. “Intermediate” issuers are required to report their ESG performance in accordance with a recognized reporting

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<sup>96</sup> Section 17 (3) IECESP

<sup>97</sup><https://www.portfolio.hu/bank/20211123/kiabrandito-jelentes-erkezett-a-bankokrol-mar-most-lemaradtak-a-klimavaltozas-elleni-harcban-512244#>; 21. 02. 2022.

standard. They are expected to set medium- and long-term ESG targets (from one year to 5 years). “Intermediate” issuers are also expected to perform within 2 years all intermediate level requirements and reach the ‘advanced level ’in the third year. To reach the "advanced level" the issuer must meet at least one "advanced level" requirement. “Advanced” issuers are required to produce an audited integrated report in accordance with a recognized ESG standard on an annual basis, to publish their financial and ESG performance. ESG information is also expected to be updated on a quarterly basis. They are also expected to set medium- and long-term ESG targets (from one year to 5 years) in accordance with certain objective schemes. “Advanced” issuers are expected to reach all of these levels within 3 years meet the relevant requirement.”<sup>98</sup>

„Hungarian Association of Investment Fund Managers and Asset Managers maintains a register of ESG-rated valuation companies accepted by the market and publishes up-to-date on its website ([www.bamosz.hu](http://www.bamosz.hu)) the most important data of the investment funds managed by its members, which will include the fund from 1 January 2021. It is also a category according to ESG criteria, so investors interested in such products will easily find these funds on the HAIFMAM website.”<sup>99</sup>

*(3) On the conflict relationship between ESG interests and client interests in portfolio management*

An investment enterprise that engages in investment lending activities shall prepare lending regulations that are approved by the board of directors and the board of directors in order to ensure that the lending is sound, transparent, and that risks are identified, managed, controlled and mitigated.<sup>100</sup> Included in the lending regulations the terms of the loan; the rules of procedure for the approval, modification, including renewal, and refinancing of credit; portfolio allocation rules consistent with the composition of the clientele and the investment enterprise's lending strategy (diversification); the rules for managing risk from credit exposures to the counter-party, groups of connected clients and clients in the same industry, geographical region or the same business or chapter, including risk mitigation techniques related to indirect large exposures; rules for the identification and management of non-performing loans, the recognition of impairment losses and the creation of provisions; the rules of procedure for the management of

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<sup>98</sup> ESG Reporting Guide for issuers of the Budapest Stock Exchange 25-26.; <file:///D:/Users/PappT/Downloads/ESG%20Reporting%20Guide%20HU.pdf>; 21. 02. 2022.

<sup>99</sup> <https://www2.deloitte.com/hu/hu/pages/jog/articles/befektetesi-alapok-esg-minositese.html>; 21. 02. 2022.

<sup>100</sup> Section 78 (1) IECESP

the risk or situation resulting from the less than expected effectiveness of the credit risk mitigation techniques recognized in accordance with a separate legal act issued pursuant to the authorization of the IECESP.<sup>101</sup> An investment enterprise shall have effective and reliable internal methods for measuring the credit risk of securities or securitisation positions and portfolio credit risk, provided that the internal method shall not rely exclusively on the credit assessment issued by an external credit assessment agency.<sup>102</sup> An investment enterprise may not provide investment credit as an ancillary service the purchase of shares issued by the lending investment enterprise, the purchase of shares issued by a sole proprietorship owned by the lending investment enterprise, and to an undertaking in which the lending investment enterprise has an ownership interest of 10% or more.<sup>103</sup> Before deciding to grant an investment loan, the investment enterprise shall satisfy itself as to the existence, fair value and enforceability of the required collateral or security and shall retain the documents supporting that decision together with the agreement on the investment credit.<sup>104</sup>

The lender of investment is obliged to develop and apply the internal lending regulations approved by the board of directors in order to ensure the soundness and transparency of lending, to assess, control and reduce risks. A transaction involving the provision of an investment loan may be concluded only in writing; in the case of an oral transaction, the conclusion of the transaction must be confirmed in writing within two working days. Investment loans may not be granted for the purchase of shares issued by the lender, for the purchase of shares issued by a sole proprietorship owned by the lender, to an undertaking in which the creditor has an interest of 10% or more. Before making a decision to grant a loan, the investment lender shall verify the existence of the necessary collateral or collateral, their fair value and enforceability. The documents on which the decision is based shall be kept together with the contract relating to the transaction.<sup>105</sup>

*(4) On the fundamental suitability of active mutual funds for shareholder activism*

Institutional investors shall disclose how the key elements of their capital investment strategy are consistent, in particular, with the profile and duration of their long-term liabilities and how

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<sup>101</sup> Section 78 (2) IECESP

<sup>102</sup> Section 78 (2a) IECESP

<sup>103</sup> Section 78 (4) IECESP

<sup>104</sup> Section 78 (5) IECESP

<sup>105</sup> Section 156 CMA

they contribute to the medium- and long-term performance of their assets.<sup>106</sup> If the asset manager invests on behalf of the institutional investor, either on the basis of portfolio management specified in the IECESP; or through an investment fund manager performing investment fund management activities specified in the public company limited by shares, the institutional investor shall disclose:

1. how the agreement with the asset manager encourages the asset manager to tailor its investment strategy and decisions primarily to the profile and duration of its long-term liabilities;
2. how the agreement encourages the asset manager to make investment decisions based on assessments of the medium and long-term financial and non-financial performance of the investee companies and to play a role in the average performance of the investee companies. and to improve it in the long term;
3. how the method used to assess the performance of the asset manager and the timing of the valuation and the remuneration of the asset management services are consistent with the profile and duration of the institutional investor's long-term liabilities and take into account long-term absolute performance.<sup>107</sup>

The asset manager shall inform the institutional investor with whom it has entered into the agreement specified above annually of the manner in which its investment strategy and its implementation comply with the agreement, as well as the contribution of the institutional investor or the fund's assets. - and long-term performance;<sup>108</sup> the information shall include a report covering significant medium to long-term investment risks; whether and how the asset manager makes investment decisions based on an assessment of the medium and long-term, including non-financial, performance of the companies involved in the investment.<sup>109</sup>

At the take over bid, the board of directors of the target company shall act in accordance with the long-term business and strategic goals of the target company.<sup>110</sup>

*(5) On the compatibility of shareholder activism with the tasks of mutual funds as financial intermediaries*

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<sup>106</sup> Section 12 (1) ELTSE

<sup>107</sup> Section 12 (2) a-c) ELTSE

<sup>108</sup> Section 13 (1) ELTSE

<sup>109</sup> Section 13 (2) a), e) ELTSE

<sup>110</sup> Section 73 (8) CMA

In order to perform its tasks related to the supervision of the financial intermediation system, the HNB records:

- financial institutions, representative offices, ancillary undertakings, intermediaries,
- undertakings providing ancillary financial services,
- the owners of the financial institution,
- senior executives of the financial institution, the independent intermediary,
- the auditors,
- those who outsource activities to a financial institution,
- the internal auditor or the head of the internal audit organization,
- applicants.<sup>111</sup>

The Act XXXVII of 2014 on the further development of the institutional framework for enhancing the security of certain actors in the financial intermediation system orders that the HNB has the right to determine the resolution/reorganization on the ground of the nature of the institution's activities, shareholder structure, legal form, risk profile, size and legal status, its interdependence with other institutions or the financial intermediation system as a whole, the scope and complexity of its activities, the institutional protection system or the institution protection scheme 575/2013 / EU membership of other mutual solidarity schemes referred to in Article 113 (7) of the IECESP, the possible effects of the provision of investment services or activities, depending on whether its insolvency and subsequent liquidation through ordinary insolvency proceedings are likely to have a material adverse effect on financial markets, other institutions, funding conditions, or the wider economy.<sup>112</sup>

The Supervisory Authority may, taking into account the principles of gradualness and proportionality, in its action in the event of a breach of the obligations laid down in IECESP suspend the exercise of the voting rights attached to the shares of the investment enterprise concerned, if the exercise of a qualified majority in the investment enterprise adversely affects the sound and prudent management of the investment enterprise, or if the person who has acquired a qualified majority in the investment enterprise fails to comply with the obligation to submit an application pursuant to Articles 37 and 37/B in relation to the acquisition or increase of the qualified majority.<sup>113</sup>

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<sup>111</sup> Section 204 (1) CIFE

<sup>112</sup> Section 4 (2) IECESP

<sup>113</sup> Section 164 (1) zsj) IECESP

In determining the extent of qualified majority, the voting rights shall be calculated on the basis of all holdings to which voting rights are attached under the terms of the investment enterprise's instruments of incorporation, irrespective of any provisions restricting the exercise of voting rights. In determining the extent of qualified majority, the voting rights pursuant to above mentioned shall be taken into account in addition to the applicant's holding. In determining the degree of qualified majority, account shall be taken of the following

(a) the voting rights of an investment fund manager or UCITS management undertaking, where the investment fund manager or UCITS management undertaking holds voting rights attached to the portfolio of securities it manages,

(b) the voting rights of an investment enterprise or credit institution, where the investment enterprise or credit institution holds voting rights attaching to the portfolio it manages may exercise the right of the applicant to exercise the functions of the investment enterprise managed by the investment enterprise on the basis of instructions given directly, indirectly or by any other means to another controlled undertaking of the applicant.

For the purposes of determining the degree of qualified majority, the voting rights of the applicant shall include the voting rights attaching to the holding, which:

(a) may be exercised by the applicant and a third party pursuant to an agreement which allows the parties to the agreement to exercise the voting rights in a coordinated manner,

(b) the applicant may exercise the voting rights on the basis of an agreement for the temporary transfer of voting rights,

(c) the applicant may exercise the right to vote in relation to a share deposited as security with him/her on the basis of an agreement,

(d) the applicant may exercise a right of usufruct in respect of a share,

(e) the controlled undertaking of the applicant may exercise on the basis of the provisions set out in points (a) to (d),

(f) the applicant may exercise as a depositary, in the absence of specific instructions from the depositary, at his own discretion,

(g) a third person may exercise on behalf of the applicant for the applicant's own account, subject to an agreement with the applicant; or

(h) the applicant may exercise the power of attorney at his own discretion, in the absence of specific instructions from the agent.

In determining the degree of qualified majority, the voting rights of the controlled undertaking of the applicant shall not be taken into account if the applicant and its controlled undertaking declare in writing, at the time of the acquisition of the shareholding, that:



(a) the voting rights will not be exercised or may be exercised by a third party independently of the applicant and its controlled undertaking and that the holding will be disposed of within one year of its acquisition,

(b) the voting rights may be exercised in accordance with specific instructions given by a third person, independent of the applicant and its controlled undertaking, by paper or electronic means,

(c) does not participate in decisions concerning the appointment or dismissal of members of the investment enterprise's decision-making, management, supervisory or administrative bodies.

In determining the degree of qualified majority, the voting rights of an investment enterprise or credit institution which is a controlled undertaking of the applicant shall not be taken into account where the investment enterprise or credit institution is authorised to carry on portfolio management activities, and

(a) on the basis of specific instructions given by it on paper or by electronic means,

(b) independently of the applicant

exercise the voting rights attached to the portfolio it manages.

In determining the degree of qualified majority, no account shall be taken of voting rights or shares which the investment enterprise may hold through placing a financial asset with a commitment to buy the asset (security or other financial instrument) (underwriting), provided that, on the one hand, it does not exercise or otherwise use those rights to intervene in the management of the issuer and, on the other hand, it disposes of them within one year of acquiring the holding.<sup>114</sup>

*(6) Specifically on the suitability of passive investment funds (index funds, ETF)*

„Mutual funds for a pre-announced purpose (eg various foreign equities purchase capital) (sell units). This goal is defined by type of investment fund. The two main groups of mutual funds are real estate mutual funds and the securities investment fund. The real estate investment fund is the accumulated assets through real estate investments, so the investment period is longer a due to the volume of investments. A securities investment fund, on the other hand, has assets invests in securities of different types, maturities and interest rates; for example: monex market fund, bond fund, equity fund, mixed fund and special fund. An ETF (Exchange Traded Fund) is a passively managed, ie. that accurately tracks the performance of the benchmark a tradable

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<sup>114</sup> Section 37/A IECESP

investment fund, primarily an equity fund. The traditional investment unlike funds, certain assets included in ETFs may not be selected by the portfolio manager relatively freely, but the specified reference index (benchmark) of the specified need to be tracked with precision. The BUX Index-Traded Fund is traded on the Budapest Stock Exchange; this is an index-traded fund that trades primarily on the stock exchange and is consistent with the BUX basket invests in the shares of the Hungarian stock exchange in proportion. The BUX index alone is not a product that can be purchased, however, the BUX ETF allows for up to a single share price the investor should buy a well-diversified portfolio covering the entire market. The BUX ETF Fund is actually an open-ended investment fund with a traditional both primary and secondary markets are marketed differently. The creating subscriptions in primary distribution is not money but the BUX index basket against an appropriate package of securities. Efficiency serves that in primary distribution only to the so-called distribution unit (HUF 1,000) an appropriate value securities package can be converted into an ETF ticket or a distribution. The value of the BUX may be the value of the ETF unit at the fund manager redeem for an appropriate portfolio of securities. The BUX ETF Fund by purchasing their investment units, investors gain access to the entire domestic market exposure as the shares in the BUX index represent 94% of the total market capitalization and they cover 99% of the trading volume of the BSE. Investors accordingly are aware of the current asset mix of the Fund. Through stock exchange trading a Units of the BUX ETF Fund can be bought and sold on the stock exchange at any time, and its liquidity is provided by a market maker.”<sup>115</sup>

*(7) Specifically on the suitability of alternative investment funds*

„The Hungarian Venture and Private Equity Association (MKME) represents the interests of the private equity and venture capital sector in Hungary by supporting its members and promoting the highest possible level of professional and ethical standards.”<sup>116</sup>

„In the Central and Eastern European region venture capital managed by established fund managers amounted to € 9 billion in 2019, that is, it accounted for 1.3% of the capital managed by European funds.”<sup>117</sup> „The investors in venture capital funds in the region have a much greater

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<sup>115</sup> Tőzsde ABC – BÉT; <https://www.bet.hu>; 22. 02. 2022.

<sup>116</sup> hvca.hu; 23. 02. 2022.

<sup>117</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3p%C3%A1ban\\_%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3p%C3%A1ban_%281%29.pdf); 6.; 23. 02. 2022.

emphasis to finance companies in their early stages of their lives.”<sup>118</sup> „The institutional investors are enterprises with the same life cycle funds set up in the same year in the Central and Eastern European region created with much smaller amounts compared to the whole. Only fund managers in the region a negligible proportion are considered to be experienced fund managers, as most of them have not yet started at least three new funds”<sup>119</sup> „The proportion of capital bonds received from state institutions in the region between 2016 and 2020 is steady increased from more than a quarter to a quarter of the capital raised each year, while Europe as a whole, the share of public capital fluctuated around 6%; however, the European share of pension funds, which account for almost 30% of venture capital fund less than 5% in the region.”<sup>120</sup> „The capital from state resources (close two-thirds, 63%) is received only two countries, Poland’s and Hungary’s capital funds.”<sup>121</sup> „Venture capitalists focus on three main sectors, ICT, consumer goods and the development of biotechnology / health in the Central and Eastern European region.”<sup>122</sup> „The highest unique investments were made by companies in the transport and finance / insurance sectors, relatively and the smallest amounts were used to finance real estate companies in the region (usually one-third to one-quarter) were represented by professional acquisitions, while the second most important exit channel is reinvestment in venture capital funds (private equity funds).”<sup>123</sup>

The rules relating to the PEPP have been incorporated into Act CXVII of 2007 on occupational pensions and its institutions from 11 April 2022, therefore the provisions of this Act shall apply to the provision and marketing of pan-European individual pension products, subject to the derogations provided for in Regulation (EU) 2019/1238 of the European Parliament and of the Council.<sup>124</sup>

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<sup>118</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 7.; 23. 02. 2022.

<sup>119</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 8.; 23. 02. 2022.

<sup>120</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 9.; 23. 02. 2022.

<sup>121</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 10.; 23. 02. 2022.

<sup>122</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 17.; 23. 02. 2022.

<sup>123</sup> KARSAI Judit „A kockázati tőke gazdaságfejlesztő hatása Kelet-Közép Európában”, [https://www.hvca.hu/documents/A\\_kock%C3%A1zati\\_t%C5%91ke\\_fejleszt%C5%91\\_szerepe\\_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf](https://www.hvca.hu/documents/A_kock%C3%A1zati_t%C5%91ke_fejleszt%C5%91_szerepe_Kelet-K%C3%B6z%C3%A9p-Eur%C3%B3pa-%281%29.pdf); 22.; 23. 02. 2022.

<sup>124</sup> Section 85 Act CXVII of 2007

In the event of a breach or deficiency in the provision or marketing of PEPP, the supervisory authority (HNB) may take the following measures, or a combination of them:

- order the cessation of the infringing conduct and refrain from repeating the infringing conduct;
- temporarily suspend the responsible manager of the person providing or distributing the PEPP service or other responsible natural person from exercising managerial functions in the person providing or distributing the PEPP service;
- impose a fine. The amount of the fine shall not exceed

(a) where the amount of the benefit derived from the infringement can be determined, twice the amount of the benefit derived from the infringement; or

(b) where the amount of the benefit derived from the infringement cannot be determined

ba) in the case of a non-natural person, HUF 1 617 250 000, or, if 10 percent of the turnover according to the annual accounts last approved by the decision-making body of the non-natural person is higher than this amount, the latter amount, provided that if the legal person is a parent company or a subsidiary of a parent company, which is required to prepare consolidated accounts under accounting law, the annual turnover to be taken into account shall be the annual turnover as shown in the consolidated accounts last approved by the parent company's decision-making body or the equivalent revenue under accounting law, and

bb) HUF 226 415 000 for a natural person.<sup>125</sup>

#### *(8) Implications of the ECB's low interest rate policy in an ESG context*

„The office market is expected to be the strongest in the real estate segment, but demand for alternative investment opportunities such as hotels and rental housing has also increased significantly. The biggest challenges next year (2022) may be the price differences between sellers and buyers and the lack of properties for sale.”<sup>126</sup>

„The extremely risky investments, forms of capital raising that the investor / client may lose a significant part (even the full amount) of the invested capital, be established and operate under appropriate official control: the companies indicated in the request for a resolution are planned. These are typical examples of a high - risk activity that is deregulated by the market and the EU legislator wanted to abolish them. See: The company “B” is the funds raised by investors from

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<sup>125</sup> Section 85/D Act CXVII of 2007

<sup>126</sup> <https://www.portfolio.hu/ingatlan/20210622/egyre-jobban-kedvelik-a-befektetok-a-berlakasokat-es-a-hoteleket-489176>; 23. 02. 2022.

each investor in accordance with the investment portfolios chosen by the invests in securities (incorporated membership's and credit relationship) and gold. The value of the profit-sharing rights is collected in Hungary by recruiting persons domiciled / resident in Hungary for the investment, therefore the activity of company "B" can be interpreted as a cross-border investment service activity, where company A, which recruits and sells clients, and the investment sales company "C" appear as intermediaries facilitating the activity. The company B, which invests client money in financial instruments, is considered to be lawful only if it is an investment enterprise / credit institution under the national law of its home member state, or it is an AIFM and is authorized by the authorities to provide investment services and if it is supervised through the authority of the so-called EU-Passport. The cross-border service provider is covered by Article 23 of MiFID may employ an agent (dependent agent) to facilitate the provision of the service."<sup>127</sup>

### **(III) Sustainable Trading / Product Governance**

#### *(1) General aspects of the reorganization of securities trading under ESG aspects*

Compliance with the relevant EU rules can be found in IECESP, in the Decree<sup>128</sup> of the Ministry of National Economy on the product approval process to be applied by the investment enterprise, and in the Recommendation<sup>129</sup> of the Hungarian National Bank (HNB) in relation to product approval requirements governing the capital market.

The HNB expects that the provisions of the recommendation will be implemented by the company in accordance with the decree of the Ministry of National Economy, and the provisions of the recommendation of HNB shall be applied in an appropriate and proportionate manner in accordance with Section 2 and Section 6 (1),<sup>130</sup> taking into account the nature of the product, the investment service and the target market for the product. The HNB also expects that if the company is both a developer and a distributor of products, it will apply the provisions of the recommendation properly, so that the considerations concerning designers and distributors are taken into account.

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<sup>127</sup> [https://alk.mnb.hu/data/cms2421196/37035\\_Alternativ\\_alap.pdf](https://alk.mnb.hu/data/cms2421196/37035_Alternativ_alap.pdf); 5.; 23. 02. 2022.

<sup>128</sup> 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>129</sup> 25/2018. (VII.5.) Recommendation of the Hungarian National Bank

<sup>130</sup> 16/2017. (VI. 30.) Decree of the Ministry of National Economy

*(2) Sustainable distribution regulation in the fund industry Part 1: Formal product release*

An investment enterprise that develops financial instruments for sale to clients shall maintain, operate and review a process for approving individual financial instruments and approving significant adjustments to existing financial instruments ("product approval process") before placing a financial instrument on the market or distribute to customers.<sup>131</sup> The product approval process establishes the identified end-user target market within each customer category of financial instruments and ensures that all relevant risks in that identified target market are assessed and that the planned marketing strategy is appropriate to the identified target market.<sup>132</sup>

An investment enterprise that develops financial instruments shall make available to any distributor all information regarding the financial instrument and the product approval process, including the identified target market for the financial instruments.<sup>133</sup> Where an investment enterprise does not offer or recommend internally developed financial instruments, it must have satisfactory arrangements in place to obtain the information referred before and to understand the characteristics and identified target markets of each financial instrument.<sup>134</sup>

An investment enterprise shall be exempted from these requirements if the investment services it provides are linked to bonds that do not contain any embedded derivatives other than the replenishment clause, or if the financial instruments are sold or marketed only to eligible counter-parties.<sup>135</sup>

The investment enterprise shall ensure that the employee involved in the design of financial instruments has the necessary expertise to understand the characteristics and risks of the financial instrument it intends to design. The investment enterprise's management body controls the enterprise's product approval process. Compliance reports to the management body shall contain information on the financial instruments developed by the investment enterprise, including information on the distribution strategy. Compliance reports shall be made available by the investment enterprise to the Supervisory Authority upon request.<sup>136</sup>

For a financial instrument, the investment enterprise shall identify the potential target market in sufficient detail and identify the type or types of clients for which the financial instrument is

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<sup>131</sup> Section 17/A (1) IECESP

<sup>132</sup> Section 17/A (2) IECESP

<sup>133</sup> Section 17/A (4) IECESP

<sup>134</sup> Section 17/A ((5) IECESP

<sup>135</sup> Section 17/A (7) IECESP

<sup>136</sup> Section 4 (1)-(2) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

compatible with its needs, characteristics and purposes. As part of this process, the investment enterprise shall identify the group or groups of clients whose needs, characteristics and objectives are incompatible with the financial instrument. If investment enterprises jointly develop a financial instrument, only one target market needs to be identified.<sup>137</sup> The investment enterprise shall decide on the suitability of the financial instrument for the identified needs, characteristics and objectives of the target market, in particular the compatibility of the risk and reward profile of the financial instrument with the target market, and ensures that the design of the financial instrument is guided by characteristics that benefit the client and does not use a business model that results in a loss to the client.<sup>138</sup> The investment enterprise shall have in place an appropriate product approval process to ensure that the products and services that the investment enterprise intends to offer or offer are compatible with the needs, characteristics and objectives of the identified target market and that the planned marketing strategy is consistent with the identified target market.<sup>139</sup> An investment enterprise shall adequately identify and assess the circumstances and needs of the clients it intends to focus on, ensuring that the interests of clients are not adversely affected by selling or financing pressures. As part of this process, the investment enterprise shall identify those client groups whose needs, characteristics and objectives are incompatible with the product or service.<sup>140</sup> An investment enterprise shall use information obtained from the developers of financial instruments and information about its own clients to develop its target market and distribution strategy. If an investment enterprise is both a developer and a distributor, you only need to make a target market assessment.<sup>141</sup> An investment enterprise shall establish and maintain procedures and arrangements for deciding on the range of financial instruments and services it offers or recommends and the relevant target markets that ensure compliance with all applicable requirements, in particular disclosure, suitability or adequacy assessment, incentives and requirements for the proper management of conflicts of interest.<sup>142</sup>

By publishing 25/2018. (VII. 5.) HNB Recommendation, the HNB ensures compliance with the European Securities and Markets Authority's (ESMA) Guidelines on MiFID II requirements for product governance (ESMA Guidelines), ESMA 35-43-620 of 5 February 2018.

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<sup>137</sup> Section 5 (1) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>138</sup> Section 5 (4) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>139</sup> Section 7 (1) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>140</sup> Section 7 (2) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>141</sup> Section 7 (3) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>142</sup> Section 8 (1) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

The potential target market cannot be identified solely based on quantitative criteria, the designer must also take due account of qualitative aspects. In particular, for mass-market services, process automation based on formulae or algorithm-based methods that process quantitative criteria for products and customers may be relevant. Such quantitative data is usually generated by some kind of scoring system (for example, using product characteristics such as volatility of financial instruments, issuer ratings, etc., or by 'converting' factual data into a numerical system). The HNB expects that the enterprise should not rely exclusively on quantitative criteria when identifying the target market, but should also balance them with qualitative criteria to a sufficient extent.<sup>143</sup> The HNB expects the designer to use the list of categories mentioned below as a basis for identifying the potential target market for the product, using each of the categories in the assessment of the target market. In doing so, the designer (a Company that produces a product, including the creation, development, release and design of a product and the provision of advice to corporate issuers on the introduction of new products) is expected to analyze the extent to which each category is relevant to the product and then determine the depth of identification in proportion to the type, nature and other characteristics of the product.<sup>144</sup> Identifying the potential target market - in sufficient detail - is a legal obligation.<sup>145</sup>

The identification of a potential target market by the developer, categories to be examined

- (1) the type of customers that make up the target group of the product ("retail customer", "professional customer" or "eligible partner");
- (2) knowledge and experience: the company provides information to potential customers on how to understand the product (they must have knowledge of the various elements, such as the product type, product characteristics and / or related thematic areas);
- (3) financial situation, with particular emphasis on loss-bearing capacity: the company specifies the percentage of loss-making capacity that potential customers must have (for example, from a small loss to a total loss), whether there is a payment obligation in excess of the amount invested (for example, the provision of additional cover, or the maximum proportion of assets that can be invested);
- (4) appropriateness of risk tolerance and product risk / return profile for the target market: the company specifies the general attitude of the target group to the investment risk (it

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<sup>143</sup> Point 3 25/2018. (VII.5.) Recommendation of HNB

<sup>144</sup> Point 4 25/2018. (VII.5.) Recommendation of HNB

<sup>145</sup> Point 7 25/2018. (VII.5.) Recommendation of HNB



is recommended to categorize and clearly characterize the basic attitude towards risk: “risk-seeking”, “speculative”, “balanced”, “conservative”);

- (5) customer goals and needs: the company specifies the investment goals and objectives of the customers of the product group, designed to meet the needs of the client, including the broader financial goals of potential clients and the overall strategy they are pursuing in relation to the investment (for example, a product can be designed to meet the needs of a particular age group, tax efficiency, depending on the tax jurisdiction of the client, or may be designed to achieve specific investment objectives, such as “currency protection”, “green investment” or “ethical investment”).<sup>146</sup>

The identification of a potential target market must be carried out in an appropriate and proportionate manner taking into account the nature of the product. This means that when identifying the target market, a product characteristics, including its complexity (including cost and fee structure), risk / reward profile or liquidity, and innovative nature.<sup>147</sup>

The HNB expects the distributor to pay particular attention to the investment services through which it offers products to the target market. In this regard, due consideration should be given to the nature of the products, in particular those products that are characterised by greater complexity or risk, or other similar characteristics (such as lack of liquidity or innovation). (This is in line with recital 18 of the MiFID II Directive.) For example, if the distributor has detailed information about some of its customers (for example, through a business relationship for investment advice), it may decide that it is in the best interests of the customers in that group to exclude access to the product in their case, given the risk/return profile of the product. Likewise, a distributor may decide to offer certain non-complex products, potentially execution-only, only based on compliance or suitability requirements in order to provide a higher level of protection to customers.<sup>148</sup>

The HNB expects the distributor to also use the category list used by the developer be used as a basis for defining the target market for your products. However, it is more appropriate for the distributor to define the actual target market, taking into account the nature of the products and the type of investment services it provides and the types of clients affected by the investment services it provides.<sup>149</sup> For the distributor it is proposed to define the actual target market for

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<sup>146</sup> Point 8 25/2018. (VII.5.) Recommendation of HNB

<sup>147</sup> Point 11 25/2018. (VII.5.) Recommendation of HNB

<sup>148</sup> Point 20 25/2018. (VII.5.) Recommendation of HNB

<sup>149</sup> Point 24 25/2018. (VII.5.) Recommendation of HNB

information on its own customer base and knowledge and, if any, information obtained from the designer or based on information from research by itself.<sup>150</sup>

*(3) Sustainable distribution regulation in the fund industry Part 2: Regular monitoring of the distribution of fund units*

In addition, the investment enterprise shall regularly review the financial instruments it offers or places on the market, taking into account any event that may materially affect the potential risk of the identified target market, at least to assess whether the financial instrument continues to meet the identified target market and whether the planned marketing strategy remains appropriate.<sup>151</sup>

The investment enterprise shall regularly review the financial instruments it has developed, taking into account any event that may have a material effect on the identified target market; during this the investment enterprise shall consider the compatibility of the financial instrument with the needs, characteristics and objectives of the target market and its distribution to the target market (the consideration also examines whether the financial instrument has been delivered to a client whose needs, characteristics and purposes are incompatible with the financial instrument).<sup>152</sup> The investment enterprise shall periodically review and update its product approval processes to ensure that they remain sound and fit for purpose and take appropriate action as necessary.<sup>153</sup> The investment enterprise shall regularly review the financial instruments it offers or recommends and the services it provides, taking into account any event that may have a material effect on the identified target market: the review shall assess at least the consistency of the product or service with the needs, characteristics and objectives of the identified target market and the adequacy of the planned marketing strategy.<sup>154</sup> The management body of the investment enterprise shall monitor the product approval process of the investment enterprise in order to determine the range of investment products and services offered or offered to the relevant target markets. This compliance reports to the management body shall include information on the products and services offered or recommended by the

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<sup>150</sup> Point 26 25/2018. (VII.5.) Recommendation of HNB

<sup>151</sup> Section 17/A (3) IECESP

<sup>152</sup> Section 5 (8) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>153</sup> Section 8 (2) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>154</sup> Section 8 (3), (4) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

investment enterprise (the investment enterprise shall make the compliance reports available to the HNB upon request).<sup>155</sup>

The HNB expects regular reviews to take place at least annually.<sup>156</sup> The developer needs to consider what information it needs on a proportionate basis how to conduct the review and how to gather this information.<sup>157</sup> The HNB expects the distributor to provide it in support of the developer's review information on sales to the developer and any other relevant information resulting from the distributor's own periodic review. In this context, the distributor is encouraged to consider any data and information that may indicate that a product is present or that the target market is no longer appropriate for the identified target market, for has become illiquid or highly volatile due to changes. This information also applies to principle of proportionality and may generally be aggregated, by asset or by sale breakdown is usually not required. However, it is recommended to provide device-specific information in cases that are particularly relevant to certain assets (for example, if the distributor concludes that a product has been misidentified by target market).<sup>158</sup>

*(4) Sustainable distribution regulation in the fund industry Part 3: Impact of asset management on the attractiveness of offering fund shares*

The aim of the HNB is to facilitate the transition of domestic credit institutions to sustainable operations and to prepare them opportunity in terms of climate change and environmental risks relevant legislative changes; in this respect, it was created on the website [www.zoldpenzugyek.hu](http://www.zoldpenzugyek.hu) (the "Knowledge Base" section provides practical help with examples, good practices and usable data, and a collection of methodological resources).<sup>159</sup> The HNB considers it important to highlight the potential business of these processes they also provide opportunities for credit institutions, which may include new or even innovative developments of financing solutions, for example for the financing of local energy communities, or the development of dedicated green banking products, such as improving energy efficiency financing and a loan related to sustainability or ESG aspects (ESG linked loan or sustainability linked loan).<sup>160</sup> The HNB expects the credit institution to identify the effects of climate change

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<sup>155</sup> Section 8 (8) 16/2017. (VI. 30.) Decree of the Ministry of National Economy

<sup>156</sup> Point 46 25/2018. (VII.5.) Recommendation of HNB

<sup>157</sup> Point 47 25/2018. (VII.5.) Recommendation of HNB

<sup>158</sup> Point 48 25/2018. (VII.5.) Recommendation of HNB

<sup>159</sup> Point I 5/2021. (IV.15.) Recommendation of HNB

<sup>160</sup> Page 4 5/2021. (IV.15.) Recommendation of HNB

and environmental damage; risks at the level of key sectors, geographical areas, products and in the context of the services in which it carries out or intends to carry out its activities given that some of these risks may materialize over a fairly long period of time.<sup>161</sup> The HNB expects the credit institution to properly document the processes in which it conducts business assess the significance of climate change and environmental risks to the environment; from the credit institution is expected to strive to ensure that these are measurable and be quantifiable.<sup>162</sup> The HNB recommends that the credit institution take steps to transition to reduce risks, such as environmentally unsustainable activities by reducing or phasing out its funding.<sup>163</sup> The HNB considers it a good practice to have a credit institution informs its customers about the environmental sustainability of their products and services climate change and environmental sustainability contribution to the objectives.<sup>164</sup> The HNB also considers climate change and environmental risks to be included in the corporate governance requirements set out in Section 109 of CIFE. Accordingly, the management body with governance powers must have sufficient knowledge and understanding of climate change and environmental risks to ensure that the level of risk assumed is consistent with the credit institution's risk appetite and strategy, internal rules and policies, and that the credit institution complies with applicable legal requirements and other obligations. For example, the HNB considers it good practice for the management body with governance powers to receive regular reports on climate change and environmental risks or to be regularly informed about them under a specific agenda item at its meetings.<sup>165</sup> The HNB also expects from the credit institution the establishment of a governing body with the power of addressing climate and environmental risks under the authority of the management body as a separate organizational unit or function responsible for the control of the ESG (as ESG center or a dedicated chief sustainability officer), or be appointed a manager to a management body with power and responsibility for managing and controlling climate change and environmental risks (for example, an executive or a control function other than the internal auditor key management position).<sup>166</sup> The HNB expects the credit institution to design its customer and counter-party rating procedures in such a way that identify and assess - by setting appropriate risk indicators or classifications - climate change and environmental risks.<sup>167</sup>

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<sup>161</sup> Point 3 5/2021. (IV.15.) Recommendation of HNB

<sup>162</sup> Points 5 and 6 5/2021. (IV.15.) Recommendation of HNB

<sup>163</sup> Point 7 5/2021. (IV.15.) Recommendation of HNB

<sup>164</sup> Point 10 5/2021. (IV.15.) Recommendation of HNB

<sup>165</sup> Point 11 5/2021. (IV.15.) Recommendation of HNB

<sup>166</sup> Point 14 5/2021. (IV.15.) Recommendation of HNB

<sup>167</sup> Point 31 5/2021. (IV.15.) Recommendation of HNB

„The HNB also attempted to determine the preparedness and climate risk exposure of credit institutions with numerical data. The preparedness of financial institutions in four areas (corporate governance, risk management, and business model and strategy and readiness for disclosures) is based on the self-reporting of credit institutions, the results of which showed a strong dispersion in the examined areas, but overall low readiness can be detected. At the business model, strategy and disclosure categories the banks - more than 75% - were significantly unprepared. This means that environmental sustainability considerations do not prevail in or with strategy-making, and the disclosures are extremely incomplete or no information is available on the sustainability actions of the financial institution, the pollution data of the financed activities.”<sup>168</sup>

The HNB conducted a long-term climate stress test to identify systemic risks arising from climate change and environmental degradation.<sup>169</sup>

*(5) Sustainable distribution regulation in the fund industry Part 4: Product intervention and prohibition*

“Data scarcity and data inconsistency are major obstacles to a proper assessment of climate risks. A challenge for green finance products and brown assets, the availability of data on climate risks is a challenge. On the other hand, it is a challenge to time horizon, with current data covering too short. The role of the financial sector in this in many cases, is still necessary to have a thorough analysis of the risks associated with climate change.”<sup>170</sup>

“ In the HNB’s approach, the main focus is on the replacement of the capacity of the Green Programme was launched in 2019 and the HNB's Internal Green Money Report was published in 2021. The HNB introduced its Green Capital Requirement Reduction Programme from 2020, which will enable the Bank to improve the energy efficiency of its Sustainability Considerations have been taken into account in one of the mandates, the amendment, the HNB will use the instruments at its disposal to support the Government's economic and environmental sustainability policy. The renewal of the resource base of the green renewal policy is thus a full can be implemented in a coherent manner.”<sup>171</sup>

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<sup>168</sup> DEÁK Viktória: MNB Zöld Program. *Polgári Szemle*, 4–6/ 2021. 107.

<sup>169</sup> DEÁK op.cit. 109.

<sup>170</sup> Fenntarthatóság és jegybanki politika – Zöld szempontok az MNB monetáris politikai eszköztárában. 16. <https://www.mnb.hu/letoltes/zold-eszkoztar-strategia-publikacio-2021-hun-0706-2.pdf> (03. 04. 2022)

<sup>171</sup> Fenntarthatóság és jegybanki politika. 19.

„The MNB introduced a capital requirement discount from 1 January 2020 for energy-efficient housing lending by banks. The application of the discount, in addition to supporting the growth of domestic green lending, encourages the green risk awareness of credit institutions and contributes to the focus on to map the risk differences between green and brown instruments. The home green loan discount can also be very well linked to the MNB's planned green mortgage bond purchase program and the green housing loan provided from the refinancing source provided by the central bank.”<sup>172</sup>

„In 2020 - according to HNB's database -, the share of green bonds issued by non-financial corporations was 11%, the green ratio of government debt securities was 3.9%, while the rate of sustainable investment was approximately 0.5%.”<sup>173</sup>

„In the balance sheet of credit institutions, the corporate capital relief program launched in December 2020 aims to shift towards industries that are less exposed to transition risks. The discount was primarily targeted at banks' green bond exposures and renewable energy loans.”<sup>174</sup>

*(6) Sustainability in investment advice Part 1: Product governance in the individual client's interest*

The investment enterprise shall appoint a staff member with appropriate expertise and competence to ensure that the investment enterprise fulfills its obligations regarding the protection of clients' financial assets and funds. Depending on the decision of the investment enterprise, this task shall be performed by the appointed person as an exclusive task or in conjunction with another task.<sup>175</sup>

An investment enterprise and a commodity exchange service provider may use an intermediary for the provision of investment services or commodity exchange services. An intermediary may be a tied agent, and an investment enterprise. The investment enterprise and the commodity exchange service provider shall be fully responsible for the intermediary activity used by it and for the observance of the provisions of the IECESP.<sup>176</sup>

The investment enterprise and the commodity exchange service provider shall be fully liable for the damage caused by the tied agent and the intermediary used by him/her in the course of

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<sup>172</sup> <https://www.mnb.hu/letoltes/zold-eszkozta-strategia-publikacio-2021-hun-0706-2.pdf> Available: 29 March 2022

<sup>173</sup> DEÁK op.cit. 108.

<sup>174</sup> DEÁK op.cit. 110.

<sup>175</sup> Section 21 (2) IECESP

<sup>176</sup> Section 111 IECESP

the investment services activity, the ancillary service, the activity of intermediation of the commodity exchange service.<sup>177</sup>

„Retail green lending can also be a serious business opportunity for the financial sector, as 97% of the real estate portfolio in Hungary is energetically outdated, which is therefore accompanied by significant CO2 emissions.”<sup>178</sup>

„In 2021 the HNB has announced the Green Mortgage Bond Purchase Program, the aim of which is to develop the domestic green mortgage bond market, which will contribute to the growth of green mortgage loans. In order to further encourage green home lending, the Green Home Program was launched as part of the Growth Loan Program, which provides low-interest green loans to households if the goal is to build and buy nearly zero energy homes.”<sup>179</sup>

#### *(7) Sustainability in investment advice Part 2: Product governance and greenwashing*

The management body of the investment enterprise shall be responsible for the risk-taking of the investment enterprise.<sup>180</sup>

The directors and members of the board of directors, the supervisory board of the financial institution and the senior executives of the financial institution in the form of a branch shall be responsible for ensuring that the authorized activities comply with the CIFE and prudential legislation and Regulation (EU) No 575/2013 in accordance with the instructions.<sup>181</sup> The senior person and the employee of the financial institution shall act in accordance with the law at all times, in accordance with the increased professional requirements associated with his/her position, with due diligence and expertise, taking into account the interests of the financial institution and the clients.<sup>182</sup>

For the information provided in the prospectus, minimum prospectus or any supplement thereto in connection with the public offering of a security, and in connection therewith compensation for damage caused to the security holder by the issuer or its directorate/executive officer/supervisory board on the ground of Civil Code or distributor, the person providing the guarantee for the rights contained in the security, the offeror or the person initiating the admission of the security to a regulated market shall be liable for this liability for a period of

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<sup>177</sup> Section 115 (4) IECESP

<sup>178</sup> DEÁK op.cit. 108.

<sup>179</sup> DEÁK op.cit. 111.

<sup>180</sup> Section 19/A (1) IECESP

<sup>181</sup> Section 140 (1) CIFE

<sup>182</sup> Section 140 (2) CIFE

five years from the publication of the prospectus; this liability cannot be validly excluded or limited.<sup>183</sup> All responsible persons are obliged to provide the prospectus, the minimum prospectus, with a separately signed statement of responsibility. The statement shall state that the prospectus or the minimum prospectus contains factual data and statements and does not conceal facts and information that would affect the situation of the security and the issuer and the person providing security for the obligation contained in the security. relevant to its assessment.<sup>184</sup>

According to the HNB, it is important to avoid that any expanding green funding turns green transactions and products that have been set up but do not have an actual environmental benefit (risk of greenwashing).<sup>185</sup> The main benefit of external certification is to maintain the “cleanliness” of the green label and reduce the risk of greenwashing. At the same time, certification is a cost disadvantage on the green side of other financial products. This element, which can in fact be considered a barrier to entry, is therefore useful on the one hand and a market in children's shoes on the other excessive restrictive effect should be avoided. The HNB will therefore analyze in detail the extent to which it is appropriate to rely on external rating agencies in connection with green products. Based on the experience abroad, the range of possibilities is very wide: it is conceivable that certification companies offering affordable services and satisfactory they provide a (purely market) solution, but there is also an example of a well-functioning model in which non-profit organizations, perhaps a public institute, play this role.<sup>186</sup>

See more in the Green Financial Product Search Concept of HNB (professional consultation document).<sup>187</sup>

*(8) Sustainability in investment advice part 3: On the regulatory and liability significance of ESG quality labels*

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<sup>183</sup> Section 29 (1) CMA

<sup>184</sup> Section 29 (2) CMA

<sup>185</sup> <https://www.mnb.hu/letoltes/zold-penzugyek-konzultacios-dokumentum-2.pdf> Page 4 Available: 30 March 2022

<sup>186</sup> <https://www.mnb.hu/letoltes/zold-penzugyek-konzultacios-dokumentum-2.pdf> Pages 27-28 Available: 30 March 2022

<sup>187</sup> <https://www.mnb.hu/letoltes/mnb-zold-penzugyi-termekkereso-szakmai-konzultacios-dokumentum-ifua-final.pdf> Available: 30 March 2022



The management body of investment enterprise shall be responsible for the integrity of the accounting and financial reporting system, including ensuring financial and operational control and compliance with laws and standards, and for providing information, disclosure and communication.<sup>188</sup> The governing body with management power is responsible for implementing the strategies and regulations of the investment enterprise.<sup>189</sup>

The investment enterprise and the commodity exchange service provider shall comply with the provisions of the laws and regulations concerning its operation and activities

- (1) the chairman and member of the board of directors and supervisory board of an investment enterprise and a commodity exchange service provider in the form of a public limited-liability company,
- (2) the chairman and member of the board of directors and supervisory board of the commodity exchange service provider operating in the form of a cooperative,
- (3) an appointed manager and deputy manager of an investment enterprise and a commodity service provider in the form of a branch, excluding an investment enterprise and a commodity service provider established in another EEA State, or
- (4) a manager of a commodity exchange service provider in the form of a limited liability company is responsible for ensuring that the material, technical, organizational and personal conditions, rules and procedures necessary for the operation and performance of the activity are in place and applied.<sup>190</sup>

The HNB issues investors warning in connection with ESG standards.<sup>191</sup>

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<sup>188</sup> Section 21/A (1) IECESP

<sup>189</sup> Section 21/A (3) IECESP

<sup>190</sup> Section 94 IECESP

<sup>191</sup> See: <https://www.mnb.hu/felugyelet/piacfelugyelet/befektetoi-figyelmeztetesek?gclid> Available: 30 March 2022

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